

Earned Income Tax Credit (EITC) - Frequently Asked Questions and Answers

General

1. What are the earned income and modified adjusted gross income (AGI) limits for 2001?

To claim the EITC in 2001, your client's earned income and modified AGI must each be less than:

- \$32,121 with more than one qualifying child
- \$28,281 with one qualifying child
- \$10,710 without a qualifying child

2. What is modified AGI?

Modified AGI for most people is the same as AGI. AGI includes items such as taxable Social Security benefits and unemployment benefits. AGI is the amount on line 33 of Form 1040, line 19 of Form 1040A, and line 4 of Form 1040EZ.

Modified AGI is figured by adding certain amounts to your client's AGI when your client:

- Shows a loss on Schedule C, C-EZ, D, E, or F,
- Claims a loss from the rental of personal property not used in a trade or business,
- Received any tax-exempt interest, or,
- Received any nontaxable distribution from a pension, annuity or individual retirement arrangement that was partly nontaxable.

Common Errors

3. What are the most common reasons for disallowance of the EITC?

Some of the more common reasons for disallowance are:

- Taxpayers claim a child who is not a qualifying child.
- Taxpayers claim a qualifying child who is also the qualifying child of someone else with a higher modified AGI.
- Married taxpayers who should file as *married filing separately*, but file as *single* or *head of household* instead.
- Income reporting errors.
- Taxpayers or qualifying children with mismatched or incorrect SSNs.

4. How can I determine whether a child meets the residency test?

If you have any reason to question whether the child lived with the taxpayer for the required time period, you may find it useful to ask further questions. Additional questions might be necessary if, for example, the taxpayer states that the child lived

with him or her for the entire year, but the taxpayer does not know the name of the child's school or care giver.

5. Must I review birth certificates to verify the age of the qualifying child?

No. However, if you have reason to question the child's age, you may want to look at the birth certificate.

6. What can I do if I experience a significant number of reject's on electronically filed returns?

If you experience a significant number of rejects, you should promptly discuss the situation with your local IRS Senior Tax Specialist in the Wage & Investment, Stakeholder Partnerships, Education and Communication Division, to identify and resolve any systemic problems. Call toll free 1-800-691-1894 to locate the closest Tax Specialist.

Recertification

7. What is EITC recertification?

EITC recertification refers to the requirement that a taxpayer whose EITC is denied or reduced for tax years starting after 1996 as a result of the deficiency procedures (upon examination) must attach a completed Form 8862, *Information To Claim Earned Income Credit After Disallowance*, to the next tax return on which the taxpayer claims the EITC. For example, if a taxpayer's EITC for 2000 is denied before the taxpayer files a return for 2001, to claim the EITC for 2001, the taxpayer must attach Form 8862. If, however, the taxpayer's 2000 claim is denied after the taxpayer files a return for 2001, but before the taxpayer files a return for 2002, Form 8862 is not required for 2001, but, Form 8862 must be attached to the return for 2002 if the taxpayer claims the EITC for that year. The recertification rules do not apply if the EITC was denied under the mathematical and clerical error procedures.

8. Is my client required to recertify when claiming the EITC for 2001?

If the EITC was denied or reduced for any tax year starting after 1996, the taxpayer should have received Letter 3094, *EIC Recertification Letter*, from the IRS after the examination was completed. Letter 3094 explains the requirement to file Form 8862. Even though the taxpayer attaches a properly completed Form 8862 to the return for 2001, the taxpayer may still be required to furnish documentation before a refund is released.

9. Is my client prohibited from claiming the EITC for a number of years?

Certain taxpayers may be prohibited from claiming the EITC for a 2 or 10 year period. The prohibition may be imposed when the EITC claimed for a year after 1996 is denied or reduced as a result of the deficiency procedures (upon examination) and the claim is determined to be due to reckless or intentional disregard of the EITC rules, or to fraud.

If the taxpayer's claim is due to reckless or intentional disregard of the EITC rules and regulations, that taxpayer will be prohibited from claiming the EITC for the next

two years. As with the Form 8862 requirement, the first year of prohibition is the first year for which a return has not yet been filed.

If the taxpayer is found to have fraudulently claimed the EITC, the taxpayer will be prohibited from claiming the EITC for the next 10 years.

In both situations, after the prohibition period is over, the taxpayer must attach Form 8862 to the next return on which the taxpayer claims the EITC.

Due Diligence

10. What do I need to do to meet the due diligence requirements of section 6695(g) of the Internal Revenue Code when preparing a return or claim for refund with the EITC?

Preparers of EITC returns and claims for refund (whether paper or electronically filed) are expected to exercise due diligence in getting accurate information to determine eligibility

and in correctly computing the EITC amount. To meet your due diligence requirements, you must:

- Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or otherwise record the information necessary to complete Form 8867 in your paper or electronic files (alternative checklist),
- Complete the appropriate earned income credit worksheet in the instructions for Form 1040, 1040A or 1040EZ, or in Publication 596, *Earned Income Credit*, or otherwise record the information necessary to complete the appropriate worksheet in your paper or electronic files (alternative worksheet),
- Have no knowledge or reason to know that any information you use in determining eligibility for, and the amount of, the EITC is incorrect, and
- Retain a copy of Form 8867 and the appropriate worksheets (or their alternatives) for three years after the June 30th following the date the return or claim for refund was presented to the taxpayer.

11. Must I use Form 8867, *Paid Preparer's Earned Income Credit Checklist*, as part of the due diligence process?

No, it is not necessary to use Form 8867 to meet the preparer due diligence requirements. However, you must either use Form 8867 or otherwise record the information necessary to complete Form 8867 in your paper or electronic files. Your electronic record must meet the requirements of Revenue Procedure 97-22, 1997-1 C.B. 652.

12. Is there a penalty for not meeting the preparer due diligence requirements?

Yes. Failure to meet the preparer due diligence requirements could result in a \$100 penalty for each failure under IRC section 6695(g). However, you may avoid the penalty with respect to a particular return or claim for refund if you can demonstrate to the satisfaction of the IRS that, given all the facts and circumstances, your normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements discussed above, and the failure to meet due diligence requirements with respect to the particular return or claim for refund was isolated and inadvertent.

Social Security Numbers (SSNs)

13. Must taxpayers and qualifying children all have SSNs?

Yes. There are several types of taxpayer identification numbers that can be used when filing a federal tax return, but only an SSN can be used when claiming the EITC. However, if a Social Security card says *"Not Valid for Employment,"* the SSN generally cannot be used when claiming the EITC.

14. How can I tell if my clients and their children have the right kind of SSNs?

If the Social Security card does not contain the legend *"Not Valid for Employment,"* then the number can be used for EITC purposes. All U.S. citizens and all aliens granted permanent resident status are entitled to receive an SSN from the Social Security Administration (SSA). Aliens who do not have permanent resident status generally cannot get an SSN unless they are entitled to certain federally funded benefits. Their Social Security cards say *"Not Valid for Employment."*

15. Must I review Social Security cards?

No. However, because the IRS uses SSNs to identify taxpayers, it is important that you explain to your clients that all names must appear on the return exactly as they appear on the Social Security card.

16. How can I avoid mismatches of SSNs?

One of the primary reasons for the rejection of a return or a delay in processing a return is an incorrect SSN. It is important that you check the accuracy of each SSN, as well as the spelling of the name associated with the number. Ask if your client received a notice of an incorrect SSN for any prior tax year.

17. If there is a mismatch, what can I do to help?

If the problem is not yet resolved:

- Have your client check the Social Security card for accuracy of the name and number on the return.
- Ask if a name or other change has been reported to the SSA.
- Determine if the problem was due to an error in recording or transcribing the number.
- Refer your client to the SSA to resolve the problem before filing a return if you cannot determine the problem.

18. Where can I learn more about surname entry formats?

A detailed discussion of surname entry formats can be found in Publication 1346, *Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns*. The specific references are in Part 1, Section 7 – Formats for Name Controls, Name Lines, and Addresses. If your software product “interprets” the name control from entries in the full name field, entries in the full name field should also conform to the name control format.